

City of Chelsea

“Steadfast”

**Five Year Financial Forecast
for Fiscal Years 2011-2015
and
Preliminary FY'11 Budget Overview**

to be Presented to the City Council

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Five Year Financial Forecast

Revenue and Expenditure Summary

| | FY'11 | FY'12 | FY'13 | FY'14 | FY'15 |
|----------------------------------|---------------|-------------|-------------|-------------|-------------|
| REVENUES | \$118,586,442 | 121,668,862 | 124,257,680 | 122,040,649 | 125,647,856 |
| % CHANGE | 0.99% | 2.80% | 2.17% | (1.78%) | 2.96% |
| EXPENSES | \$121,966,267 | 123,796,063 | 123,626,074 | 124,596,751 | 128,069,034 |
| % CHANGE | 3.87% | 1.50% | (0.14%) | 0.79% | 2.79% |
| SURPLUS (DEFICIT) | (\$3,379,825) | (2,127,201) | 632,607 | (2,556,102) | (2,421,178) |
| FREE CASH BALANCE w/o CUTS | (\$87,676) | (1,489,877) | (132,270) | (2,163,372) | (4,059,550) |

Understanding the Numbers

REVENUES

■ LOCAL AID

- General Gov't – OUCH – FY'11 – assumes another 3% CUT (\$217k).
 - Non-school Local Aid is \$3.6m below FY'01 high (\$10.6m), unadjusted for inflation (DOWN 34%).
 - Non-school Local Aid is \$7m below FY'01 high, adjusted for inflation (OFF 50%).
- Schools – assumes Gov.'s recommendation, which wrapped stimulus funding into Chapter 70 and resulted in a \$1.7m increase in funding.
- It is hard to predict any significant increase in Local Aid in the out-years because of State's own budget issues.

■ OTHER

- Meals Tax of \$212k estimated for FY'11 is significantly lower than initial estimates provided by State DOR (\$800k). Hotel tax is down (\$40k to \$210k) even with adoption of new increased rate.

Understanding the Numbers

REVENUES

■ OTHER (continued)

- Tax Levy is projected to grow by 2.5% (\$883k) plus New Growth (\$600k). The New Growth is lower in FY'11 when compared to more robust growth numbers in the previous years (FY'10 - \$1.24m).
- Overlay provision remains at the reduced level of 1.5% of the prior year levy (\$530k).
- Fines & Forfeits and Licenses & Permits up 7% (\$200k to \$3.1m).
- Trash fees are expected to rise in the area of 5% yearly (\$75k in FY'11 to \$1.6m).
- Interest on Investment is projected to be level (\$1m).
- Excise tax increases almost 10% (to \$3.5m), providing more than \$300k in new revenues for FY'11.

Understanding the Numbers

EXPENSES

- Overall spending is projected to increase by 3.9% in FY'11 (up \$4.5m).
- School Department spending is projected to increase by 4.4%, or \$2.7m (driven by Chapter 70 and stimulus funding), while all other spending is up 3.2% (\$1.8m).
- The cost of core municipal services (also known as “discretionary spending” which excludes schools, debt services, employee benefits and assessments) is down 0.1% (\$2k) in FY'11.
- Wage increases are assumed to be 0% in FY'11 and FY'12, and then 1%, 1% and 2% from FY'13-'15.
- Health Insurance rates are up 10.0% in FY'11. However lower head counts and other administrative adjustments will result in an estimated increase of 5% (\$315k) for the City. On the School side, those savings items and increased contributions by employees result in a level funded Health Insurance cost.

Understanding the Numbers

EXPENSES

- Retirement costs – The City continues to follow the recommended funding schedule, which results in a 3.9% increase in costs (\$207k to \$5.6m) for FY'11. Various state proposals exist to reduce that cost for municipalities.
- Debt Service is up in FY'11 (by 4%, or \$413k, for CIP and Urban Renewal activities) but reduced for the 5 year period (by 50%). Points of interest on Debt Service include:
 - The City is making a conscious effort to avoid adding too much new debt during this period of fiscal uncertainty. That decision does reduce general infrastructure spending.
 - The retirement of the new schools loans will take place in 2016.
 - Leveling of payments from the State for new schools increases deficits in FY'11-'12 and generates a surplus in FY'13. The impact in FY'11 adds \$900k to the projected deficit.
 - There is a balloon payment in the \$5m range in FY'16 that is provided for at that time through a trust fund set aside for that specific purpose.
 - Total Debt Service in FY'17 could be in the \$3m range.
- The School Department maintains expenditure reduction plans in the event that volatile school funding accounts change to the negative.

Budget Pressures

SUMMARY

- Any economic recovery underway is not providing relief for the City budget.
- The chronic State budget crisis continues to impact revenues!
- The City is controlling discretionary spending, however some non-discretionary spending, like Health Insurance and Pensions, continues to rise beyond inflation.
- Health Insurance premiums are up 10%, and only manageable as a result of layoffs and higher employee contributions.
- Retirement funding, hit hard but are bouncing back from the stock market collapse, continues increasing. State proposals do exist to limit that burden on cities.
- Significant cost-cutting measures may be exhausted, unless the City began to consider, for examples, reduce library hours, closing the senior center or taking a fire piece out of service.
- Regional efforts are underway but will not provide immediate financial benefits.
- Collective bargaining is ongoing with the City asking for wage and benefit relief.
- In FY'10, the City eliminated 29 positions and the Schools 36. In FY'11, the Schools plan on eliminating 19.5 more positions. The City's intentions in FY'11 regarding position elimination will be determined by collective bargaining efforts.
- Property taxes are increasing by 2 ½% annually but New Growth is below recent higher levels as the economy causes new project delays or abandonments.

Budget Pressures

SUMMARY – (continued)

- Unlike declines in other major revenues, Excise Tax payments are growing.
- Non-school Local Aid losses this decade are \$17m, in constant dollars, and \$33m, adjusted for inflation.
- While non-school Local Aid is down 34% since FY'01 highs, School Aid is up 54% during that same time. Despite an FY'11 increase, the School Dept. must reduce spending and utilizing stimulus funding to keep budget in balance.
- As reserves dwindle, the City's financial flexibility becomes more restricted.
- The City needs to continue to:
 - Control spending,
 - Promote new revenue growth through economic development and entrepreneurial activities, and
 - Lead state debate on local aid, health insurance, pensions and regionalism.
- Otherwise, the City faces the potential of:
 - A depletion and maybe elimination of Stabilization balances,
 - Deep service cuts that are a result of significant layoffs,
 - A Proposition 2 ½ override,
 - Something worse!

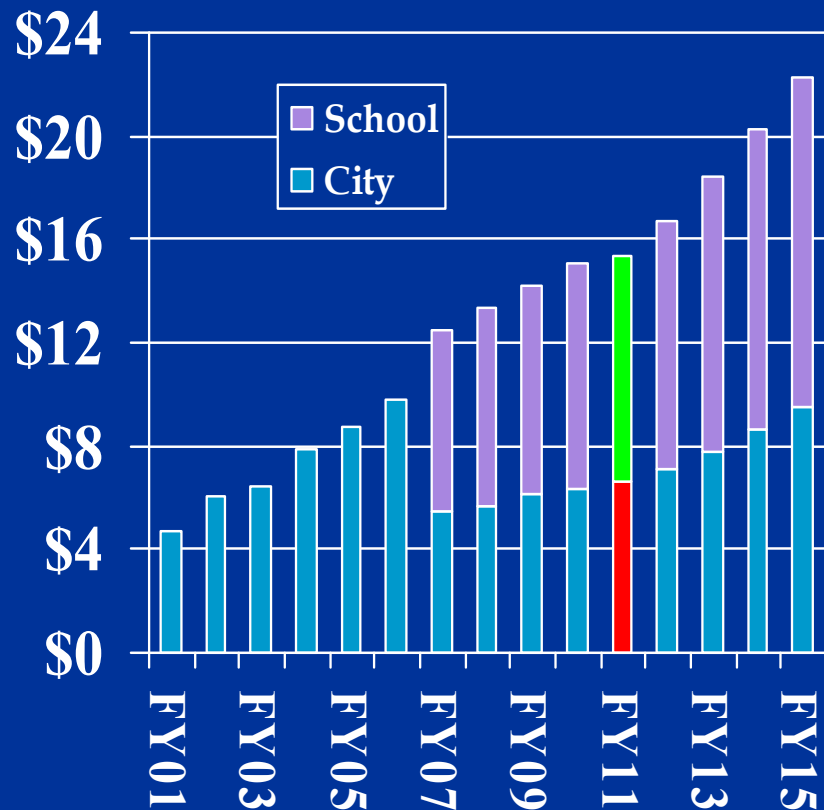
Budget Pressures

Expenditures:

- By contract, the City covers 85% for HMO and 75% of Indemnity and Medex costs for employees and retirees. In FY'11, Schools will cover 82.5% for HMO. The City is negotiating a similar change.
- The City has attempted to control costs by joining the City of Boston's health insurance system; agreeing to higher co-pays and employee contributions, and reducing the overall number of plans offered.
- Despite those efforts, Health Insurance costs to the City and Schools has risen \$10.7m, for an average combined 7% increase, from FY'01-FY'11. Premiums have risen approx. 10% a year during that period.
- Premiums are assumed to continue to increase by 10% from FY'11-'15.
- The difference between premium increases and actual costs relate to the number of employees covered and the percentage of the premiums paid by employees.
- If municipal and school employees were covered by the State's health insurance system, it is estimated that the City, Schools and employees would save \$2.5m - \$3.5m in premium payments in FY'11, although higher co-pays would reduce the net savings.

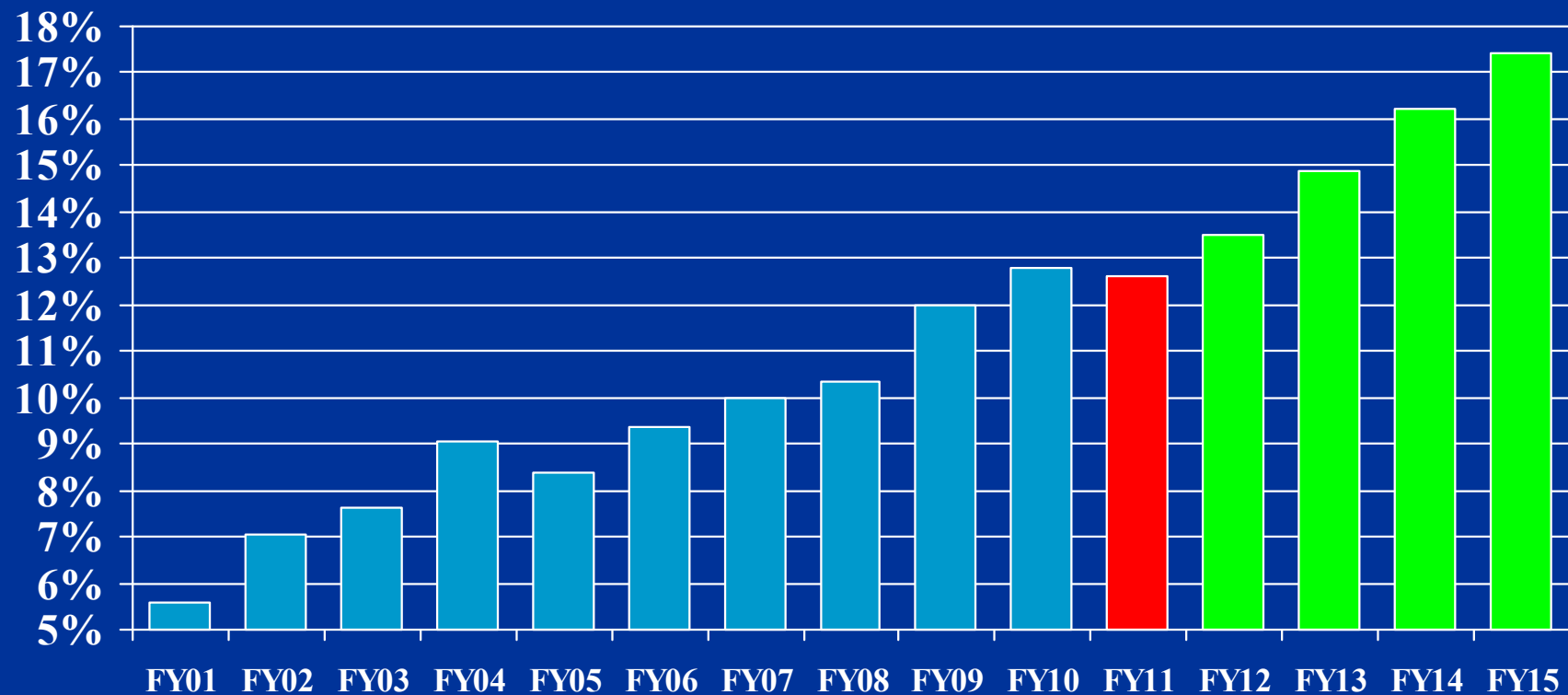
Health Insurance Costs

amounts in millions - net of employee contributions



Budget Pressures

Health Insurance as Percent of Total Budget



Reflects combined City and School expenditures

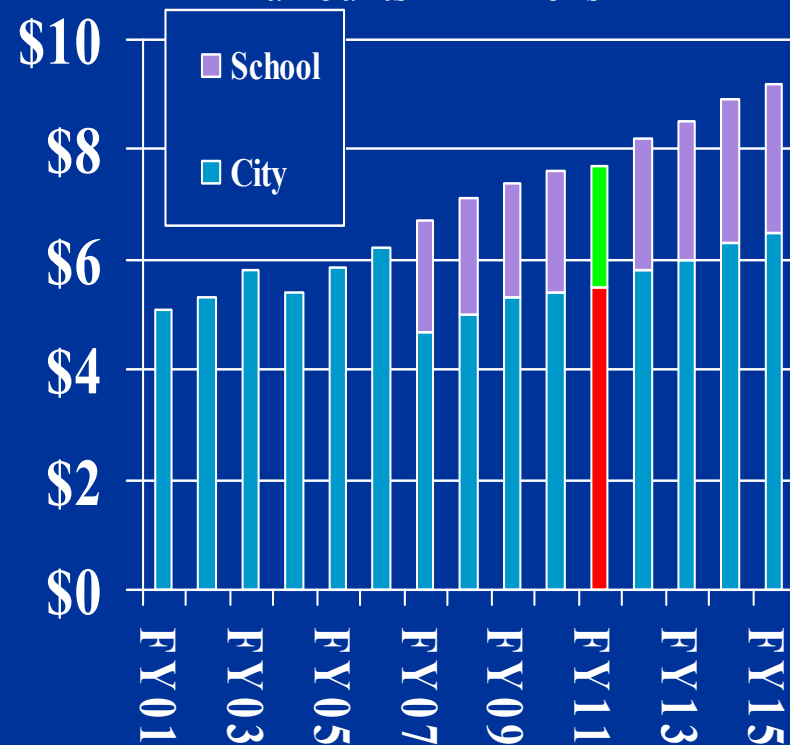
Budget Pressures

Expenditures:

- The City voluntarily entered and remains in the State's system for pension asset management.
- The City is required to make annual payments into its Retirement System as a benefit to employees and on a schedule to fully fund the system by 2030.
- Stock market losses and general budgetary pressures will likely result in the State allowing communities to extend that repayment schedule to 2040, which the City is likely to implement.
- Approximately 75% of annual charges reflect "catch-up" payments to fully fund the system. Thus, the elimination of future positions only impacts 25% of the annual retirement charges.
- Catch-up payments continue to grow into 2029, including approx.\$6m in FY'11 to almost \$12m in FY'29.
- Retirement costs, Schools included, increased by an average of 4.5% from FY'01 to FY'11, and are projected to rise at twice the rate of overall budget growth in the out-years.
- Teacher retirement costs are paid through a statewide system and are not reflected in the School's calculation.

Retirement Costs

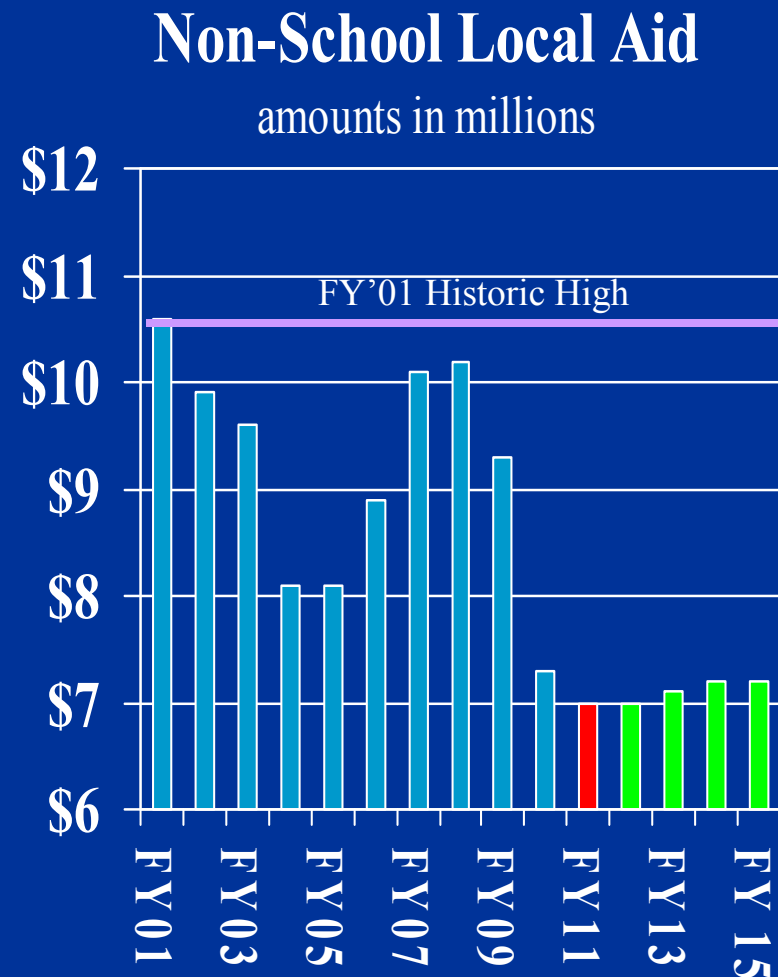
amounts in millions



Budget Pressures

Revenues:

- Non-school Local Aid (LA) is Unrestricted General Gov't Aid, which was established as the combination of Lottery Aid and Additional Assistance by the State in FY'10.
- Although the Gov. has proposed level funding LA, legislative leaders have suggested otherwise. This forecast assumes a 3% cut (\$217k) in LA.
- For FY'11, LA of \$7.0m is \$3.6m less than the FY'01 high of \$10.6m, or 66% of the historic LA high.
- The cumulative loss in LA from FY'01-'11 is \$17.2m (meaning \$17.2m in Free Cash/cuts have been used to make up for LA shortages).
- Adjusted for inflation since FY'01, LA is down \$7m for FY'11, far eclipsing the City's proposed deficit (\$3.3m). The cumulative loss of inflation-adjusted LA from FY'01-'11 is \$33m.



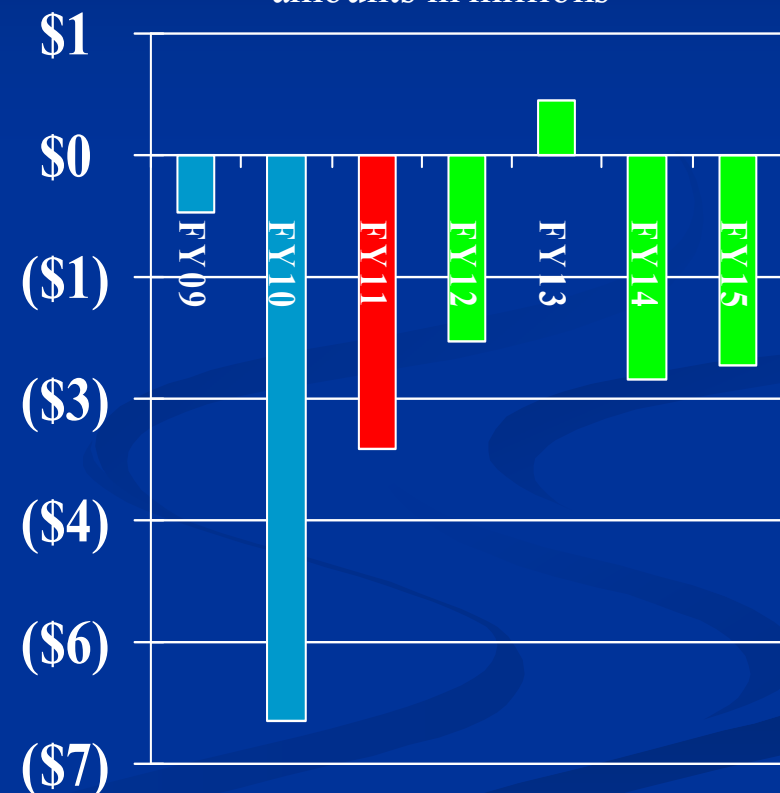
Budget Pressures

FIVE YEAR DEFICITS:

- Deficits, driven by reduced non-school Local Aid and skyrocketing Employee Benefit costs, exist in four of the next five years:
 - FY'11 (\$3.380m)
 - FY'12 (\$2.127m)
 - FY'13 \$0.633m
 - FY'14 (\$2.566m)
 - FY'15 (\$2.421m)
- The cumulative deficit for 5 years is \$9.9m.
- The FY'13 surplus, which partially offsets the deficits in the other four years, is a result of a reduced school loan repayment.
- The City is not alone in projecting deficits. Many other municipalities are experiencing similar budgetary pressures, or worse.
- Prudent City management has led to fund balances that are offsetting deficits. More expenditure cuts or revenue growth will be required, though, to avoid the complete elimination of reserves.

Projected Deficits

amounts in millions



Budget Pressures

Year End Balances and Items of Impact

| <u>FY'11</u> | <u>FY'12</u> | <u>FY'13</u> | <u>FY'14</u> | <u>FY'15</u> |
|--------------|--------------|--------------|--------------|--------------|
|--------------|--------------|--------------|--------------|--------------|

Projected (Deficits) and Surpluses

| | | | | |
|----------------------|---------------|-----------|---------------|---------------|
| (\$3,379,825) | (\$2,127,201) | \$632,607 | (\$2,596,102) | (\$2,421,178) |
|----------------------|---------------|-----------|---------------|---------------|

Reduced Local Aid (from FY'01 high (\$10,627,357), unadjusted for inflation)

| | | | | |
|--------------------|-------------|-------------|-------------|-------------|
| \$3,608,319 | \$3,608,319 | \$3,538,128 | \$3,467,236 | \$3,395,635 |
|--------------------|-------------|-------------|-------------|-------------|

Reduced Local Aid (from FY'01 high, adjusted for inflation, 2% in future years)

| | | | | |
|--------------------|-------------|-------------|-------------|-------------|
| \$6,632,003 | \$6,905,023 | \$7,113,314 | \$7,306,472 | \$7,544,603 |
|--------------------|-------------|-------------|-------------|-------------|

Health Insurance Increases (Projected FY'11-'15)

| | | | | |
|------------------|-----------|-----------|-----------|-----------|
| \$315,007 | \$496,137 | \$711,129 | \$782,242 | \$860,467 |
|------------------|-----------|-----------|-----------|-----------|

Retirement "Catch-Up" Charges (Projected FY'11-'15)

| | | | | |
|--------------------|-------------|-------------|-------------|-------------|
| \$6,111,998 | \$6,341,998 | \$6,578,992 | \$6,825,705 | \$7,081,669 |
|--------------------|-------------|-------------|-------------|-------------|

Deficit Reduction Plan

Assuming no other revenue increases beyond those already projected, the five year plan to address the yearly deficits is:

| | FY'11 | FY'12 | FY'13 | FY'14 | FY'15 |
|-------------------------|---------------|---------------|-------------|---------------|---------------|
| Deficit | (\$3,379,825) | (\$2,127,201) | \$632,607 | (\$2,596,102) | (\$2,421,178) |
| Use of Free Cash | \$2,500,000 | \$1,500,000 | 0 | \$1,750,000 | \$1,750,000 |
| Add'l One- Time Cuts | \$879,825 | \$627,201 | 0 | \$846,102 | \$671,178 |
| Est. Free Cash Left | \$1,517,149 | \$742,149 | \$1,899,756 | \$674,756 | (\$550,244) |

NOTE: The average cost to the City per employee is approximately \$70,000 including benefits. Therefore, to eliminate \$1,500,000 in Free Cash uses, for example, approximately 21 additional positions would need to be eliminated.

NOTE: A \$600,000 structural adjustment in FY'11 only, instead of one-time cuts, would provide the same impact on Estimated Free Cash in FY'15 as making each of the add'l one-time cuts. That illustration can be found on the next slide.

Deficit Reduction Plan

Assuming no other revenue increases beyond those already projected, the five year plan to address the yearly deficits is:

| | FY'11 | FY'12 | FY'13 | FY'14 | FY'15 |
|------------------------------|---------------|---------------|-------------|---------------|---------------|
| Deficit | (\$3,379,825) | (\$2,127,201) | \$632,607 | (\$2,596,102) | (\$2,421,178) |
| Use of Free Cash | \$2,779,825 | \$1,527,201 | 0 | \$1,996,102 | \$1,821,178 |
| Permanent Cut | \$600,000 | 0 | 0 | 0 | 0 |
| Value of Permanent Cut | \$600,000 | \$600,000 | \$600,000 | \$600,000 | \$600,000 |
| Est. Free Cash Left | \$1,237,324 | \$435,123 | \$2,192,730 | \$721,628 | (\$574,550) |

NOTE: To end FY'15 with a \$0 Free Cash balance, the Permanent Cut in FY'11 would need to be approximately \$715,000. Utilizing the \$70,000 per employee calculation, 10 employees would need to be laid-off to accomplish the \$0 Free Cash plan.

Projected Use of Reserves

Based upon Slide 15

| | FY10 | FY11 | FY12 | FY13 | FY14 | FY15 |
|--|-----------|-------------|-------------|-----------|-------------|-------------|
| <u>General Fund</u> | | | | | | |
| Free Cash Certified at Start of Year | 2,442,149 | 3,292,149 | 1,517,149 | 742,149 | 1,899,756 | 674,756 |
| Free Cash (Used) or Generated | 0 | (2,500,000) | (1,500,000) | 632,607 | (1,750,000) | (1,750,000) |
| Supplemental Appropriations of Free Cash | (500,000) | (125,000) | (125,000) | (125,000) | (125,000) | (125,000) |
| Years Net Activities Affecting Free Cash | 1,350,000 | 850,000 | 850,000 | 650,000 | 650,000 | 650,000 |
| Free Cash Estimated at Year End | 3,292,149 | 1,517,149 | 742,149 | 1,899,756 | 674,756 | -550,244 |

Note: additional cuts would be required to balance the budget

Stabilization Balance at start of Year

| | | | | | | |
|-------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| General 7020 | 4,021,074 | 4,161,812 | 4,328,284 | 4,501,415 | 4,681,472 | 4,868,731 |
| Capital 7022 | 932,640 | 965,282 | 999,067 | 1,034,034 | 1,070,226 | 1,107,684 |
| Planning and Development 7021 | 156,207 | 161,674 | 167,333 | 173,189 | 179,251 | 185,525 |

assuming a 3.5% investment return

Recap of FY'10

The adopted FY'10 Budget contained cuts to half the City's departments.

After the budget was adopted, State Aid reductions and other revenue shortfalls resulted in the City making further reductions of \$2.3m. Those adjustments included:

Revenues

- Non-school Local Aid drop of another \$1.2m (on top of previous cuts of \$1.7m since the beginning of FY'09)
- School Aid drop of \$1m
- Building Fee drop of \$0.5m
- Interest Income drop of \$0.4m
- Offset partially by Excise Tax Growth of \$1m

Expenses

- General Gov't cut \$1.2m, including 29 positions
- Schools cut \$1.4m, including 36 positions
- Debt Services up \$0.3m

Potential Future Budget Impacts

ON THE POSITIVE

- The City was not one of the 22 communities that sought a Proposition 2 ½ override in 2009.
- Switching to the State's health insurance system could save 15-20% of health insurance premiums, estimated to be more than \$2.5m, for the City, Schools and employees, and lead to smaller annual increases going forward.
- The City is active in statewide policy discussions that could lead to reduced impacts from health insurance, retirement and charter school costs, as well as the regionalization of services to maintain and improve efficiencies.
- Promising economic development could lead to further increases in building fees, property taxes, hotel/motel excise taxes and motor vehicle excise taxes.
- As other communities experience more dire difficulties, the solutions to their problems may provide a benefit to the City.
- Reserves, if combined with additional cuts and revenue enhancements, do provide a method to assure balanced budgets for at least the next 5 years.

Potential Future Budget Impacts

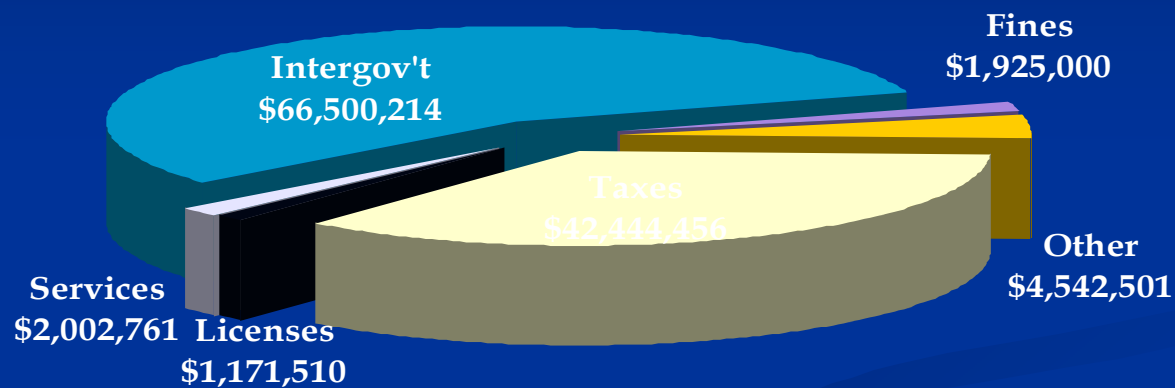
ON THE NEGATIVE

- The aggressive economic development agenda that the City has relied upon to avoid even more substantial budgetary gaps in the past has components that are now stalled.
- The lingering State budget crisis could lead to further local aid reductions and other revenue impacts.
- Motor Vehicle Excise Tax receipts could be reduced if local airport related parking is negatively impacted by future airport and airline issues, or if consumers continue to put off buying new or newer vehicles.
- The adoption of the meals and hotel taxes have produced nominal revenue increases that have not made up for deep local aid cuts.
- Potential federal reductions in Medicare reimbursements could result in funding shortfalls to support necessary school health programs.
- Stabilized utility costs could return to higher levels.
- Failure to replenish reserves, or completely spending reserves down, could require dramatic service impacts or a need for a Proposition 2 ½ override if the current economic downturn is prolonged.

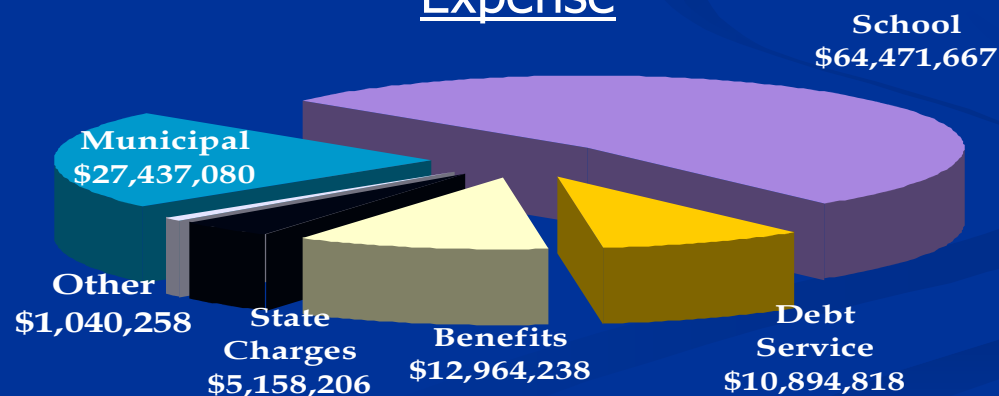
FY'11 Budget

General Fund Revenue & Expenses

Revenue



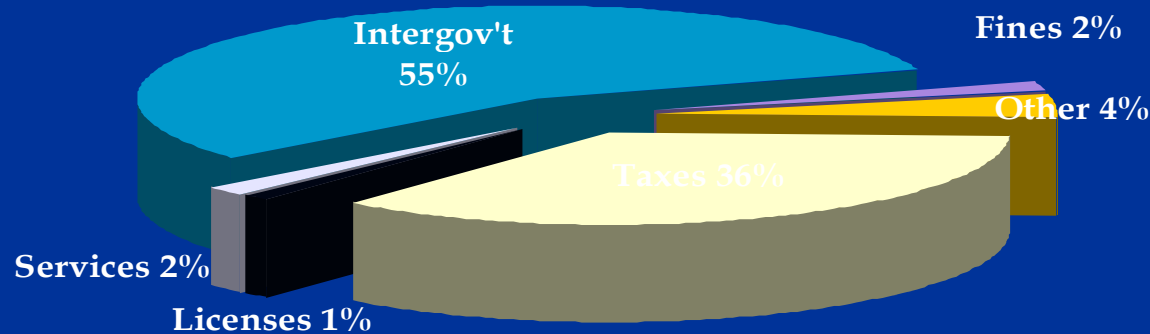
Expense



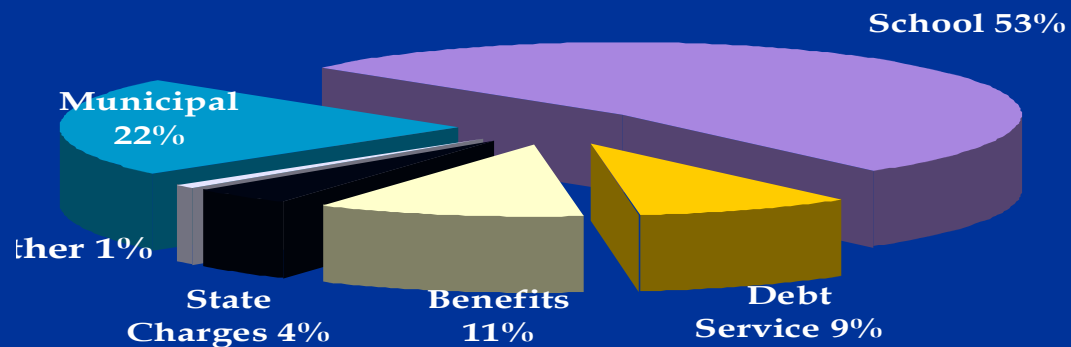
FY'11 Budget

General Fund Revenue & Expenses

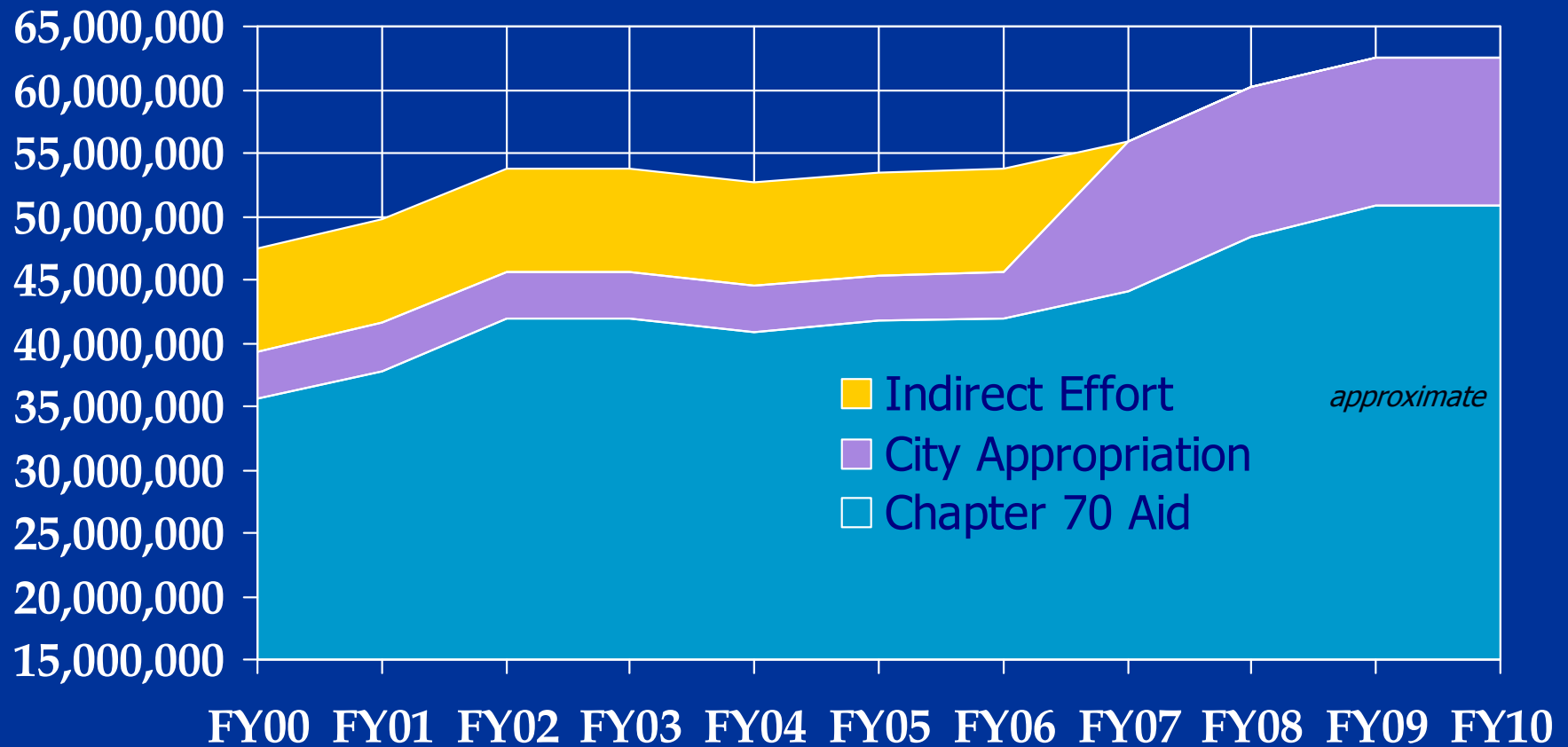
Revenue



Expense



School Department Funding



Water and Sewer Enterprise Funds

- Enterprise Funds recover costs for providing Water & Sewer services. Those funds project slight surpluses going into FY'11.
- User fees account for 98% or more of the revenues.
- The MWRA Assessments accounts for between 55-60% of costs.
- The preliminary assessments from MWRA is for a 13.5% increase, relating to new population estimates that reflect a continued growth in the City's population, up to 41,000 persons, versus other communities.
- The City aims to hold new charges under 10% and maybe lower with additional cost savings related to the implementation of the new metering system.
- Other charges to the funds include direct expenses to pay the RH White maintenance contract, indirect expenses to pay for other employee allocation costs of the General Fund and debt services to pay for the continuing update of water and sewer infrastructure.
- The City seeks to keep costs down by controlling debt service, but must also update a system that still has significant age to it.
- Local charges are about average when compared to other MWRA users communities.

Municipal Costs Affordability Index

- The City reviews data from 7 neighboring cities (Boston, Everett, Lynn, Malden, Revere, Somerville and Winthrop) to chart a Municipal Costs Affordability Index. Below, the chart refers to those communities anonymously, but lists out average property tax and water & sewer bills for the average single-family owner occupied unit in each city in FY'09.
- The data below indicates that municipal charges are less in Chelsea than all other cities.

| City | Average Tax Bill | Combined Water & Sewer Bill | Combined Homeowner Costs | % Above Chelsea Cost |
|----------------|------------------|-----------------------------|--------------------------|----------------------|
| A | \$3,638 | \$1,448 | \$5,086 | 61% |
| B | \$3,318 | \$1,290 | \$4,608 | 46% |
| C | \$3,318 | \$1,069 | \$4,387 | 39% |
| D | \$3,109 | \$1,257 | \$4,366 | 38% |
| E | \$2,923 | \$971 | \$3,894 | 23% |
| F | \$2,762 | \$1,019 | \$3,781 | 20% |
| G | \$2,557 | \$674 | \$3,231 | 2% |
| <i>Average</i> | <i>\$2,954</i> | <i>\$1,111</i> | <i>\$4,064</i> | <i>29%</i> |
| Chelsea | \$2,003 | \$1,156 | \$3,159 | |

Conclusion

- The current municipal finance environment, of trouble for the last ten fiscal years and the most severe since the Great Depression, continues to threaten the viability of municipalities throughout the commonwealth and country.
- Despite that, the City is succeeding at managing through these tough times.
- Out-years are severely impacted by reduced non-school Local Aid and growth in non-discretionary spending areas, most notably, health insurance and pensions. The City has played a significant role in raising the statewide debate about these three “Budget Busters.”
- With about 55% of the City’s revenue coming from Local Aid (down from 67% in FY’01), the lagging State budget crisis continues impacting the City’s budget. In FY’11, non-school Local Aid will provide only 66% of that from FY’01.
- In FY’11, the City will receive \$3.6m less in non-school Local Aid since its \$10.6m high in FY’01. That reduction, when adjusted for inflation, is \$7m. Cumulatively, non-school Local Aid reductions have cost the City \$17m from FY’01-’11; \$33m when adjusted for inflation.
- The School budget requires cuts, as modest increases in funding are not sufficient to cover contractual increases and a rise in health insurance and pension costs. The Schools maintain contingency plans for additional cuts should funding decrease. Those additional cuts will result in increased class sizes and the elimination of some programs.

Conclusion

- Central to City's deficit reduction plans is the development of more than 1,200-units of housing. Progress toward achieving that goal has slowed as a result of the economy, putting more pressure on reserves and requiring more austerity measures, including position eliminations.
- A municipal tax and fee study examining property tax and water & sewer fees for the City and seven neighboring communities finds that the City is the least expensive place to be a single-family owner occupant.
- With no local Proposition 2 ½ overrides projected, the City's relative affordability should remain as such, but the City will struggle to maintain and expand core municipal services.
- There is little margin for error, or, more likely, little margin for additional impacts from a State budget in crisis or a further decline in the economy. Any further substantial impact will potentially result in a disastrous local result.
- The City saved in "good times" to have reserves to fund operations in "bad times." Those reserves have been counted upon to provide budget stability during these tough financial times, while the City looks for cost savings and revenue enhancements elsewhere to continue budget stability into the out-years.
- Absent a sustained recovery, additional actions, on top of the judicious use of reserves will be required to maintain budget stability in the out-years and beyond.